



[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9636]

RIN 1545-BE18

Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains amendments to correct the final regulations (TD 9636) that provided guidance on the application of sections 162(a) and 263(a) of the Internal Revenue Code (Code) regarding the deduction and capitalization of expenditures related to tangible property. These regulations were published in the **Federal Register** on Thursday, September 19, 2013 (78 FR 57686).

DATES: This correction is effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, and is applicable beginning September 19, 2013.

FOR FURTHER INFORMATION CONTACT: Merrill D. Feldstein at (202) 317-5100 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (TD 9636) that are the subject of this correction provide guidance under sections 162(a) and 263(a) of the Code to amounts paid to acquire, produce, or improve tangible property and affect taxpayers that acquire, produce, or improve tangible property.

In addition to correcting a number of typographical and syntactical errors, these correcting amendments clarify the manner of electing to capitalize and depreciate the cost of any rotatable spare part, temporary spare part, or standby emergency spare part under §1.162-3(d). As published, §1.162-3(d)(3) of the final regulations could be misleading regarding the manner of making this election. The election is made by capitalizing the amounts paid to acquire or produce a material or supply and by beginning to depreciate the designated amounts under the rules for accounting for property depreciated under the Modified Accelerated Cost Recovery System (MACRS) under section 168 (MACRS property). The final regulations are corrected to clarify this point.

A similar election to capitalize and depreciate the cost of materials and supplies was provided under §1.162-3T(d) of the temporary regulations published in the **Federal Register** on Tuesday, December 27, 2011 (TD 9564) (76 FR 81060). While the temporary regulations (TD 9564) were removed from the **Federal Register** on September 19, 2013, in conjunction with publication of the final regulations (TD 9636), the final regulations permit taxpayers to choose to apply §1.162-3T(d) to amounts paid or incurred (to acquire or produce property) in taxable years beginning on or after January 1, 2012, and before January 1, 2014. The language in §1.162-3T(d)(3) describing the manner of

electing to capitalize and depreciate the cost of materials and supplies is similar to the language in §1.162-3(d)(3) of the final regulations and could be similarly misleading. However, because the temporary regulations have been withdrawn, the language in §1.162-3T(d)(3) cannot be corrected. Therefore, for good cause to prevent any confusion for taxpayers who choose to apply §1.162-3T(d) as contained in TD 9564 (76 FR 81060) December 27, 2011, to amounts paid or incurred (to acquire or produce property) in taxable years beginning on or after January 1, 2012, and before January 1, 2014, §1.162-3(j)(3) is clarified to provide that the manner for making the election under §1.162-3T(d)(3) is the same as the manner for making the election under §1.162-3(d)(3). In both cases, the election is made by capitalizing the amounts paid to acquire or produce designated materials or supplies and by beginning to depreciate these amounts under the rules for accounting for MACRS property.

Need for Correction

As published, the final regulations contain errors that may prove to be misleading and are in need of clarification.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.162-3 is amended by:

1. Revising the last sentence of paragraph (c)(4)(i).
2. Revising the first sentence of paragraphs (c)(4)(ii), (d)(1), and (d)(2).
3. Revising paragraph (d)(3).
4. Revising the fourth sentence of paragraph (e)(1).
5. In paragraph (j)(3) removing the text “section” wherever it appears and adding “§” in its place, and adding two new sentences after the first sentence of the paragraph.

The revisions and addition read as follows:

§1.162-3 Materials and supplies.

* * * * *

(c) * * *

(4) * * *

(i) * * * The factors that must be considered in determining this period are provided under §1.167(a)-1(b).

(ii) * * * For taxpayers with an applicable financial statement (as defined in paragraph (c)(4)(iii) of this section), the economic useful life of a unit of property, solely for the purposes of applying the provisions of this paragraph (c), is the useful life initially used by the taxpayer for purposes of determining depreciation

in its applicable financial statement, regardless of any salvage value of the property. * * *

* * * * *

(d) * * *

(1) * * * A taxpayer may elect to treat as a capital expenditure and to treat as an asset subject to the allowance for depreciation the cost of any rotatable spare part, temporary spare part, or standby emergency spare part as defined in paragraph (c)(2) or (c)(3) of this section. * * *

(2) * * * A taxpayer may not elect to capitalize and depreciate under this paragraph (d) any amount paid to acquire or produce a rotatable, temporary, or standby emergency spare part defined in paragraph (c)(2) or (c)(3) of this section if--

* * * * *

(3) Manner of electing. A taxpayer makes the election under this paragraph (d) by capitalizing the amounts paid to acquire or produce a rotatable, temporary, or standby emergency spare part in the taxable year the amounts are paid and by beginning to depreciate the costs when the asset is placed in service by the taxpayer for purposes of determining depreciation under the applicable provisions of the Internal Revenue Code and the Treasury Regulations. Section 1.263(a)-2 provides for the treatment of amounts paid to acquire or produce real or personal tangible property. A taxpayer must make the election under this paragraph (d) in its timely filed original Federal tax return (including extensions) for the taxable year the asset is placed in service by the taxpayer for purposes of

determining depreciation. Sections 301.9100-1 through 301.9100-3 of this chapter provide the rules governing extensions of the time to make regulatory elections. In the case of an S corporation or a partnership, the election is made by the S corporation or partnership, and not by the shareholders or partners. A taxpayer may make an election for each rotatable, temporary, or standby emergency spare part that qualifies for the election under this paragraph (d). This election does not apply to an asset or a portion thereof placed in service and disposed of in the same taxable year. A taxpayer may revoke an election made under this paragraph (d) or made under §1.162-3T(d), as contained in 26 CFR part 1, revised as of April 1, 2013, only by filing a request for a private letter ruling and obtaining the Commissioner's consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith and the revocation will not prejudice the interests of the Government. See generally §301.9100-3 of this chapter. The manner of electing and revoking the election to capitalize under this paragraph (d) or under §1.162-3T(d), as contained in 26 CFR part 1, revised as of April 1, 2013, may be modified through guidance of general applicability (see §§601.601(d)(2) and 601.602 of this chapter). An election may not be made or revoked through the filing of an application for change in accounting method or, before obtaining the Commissioner's consent to make the late election or to revoke the election, by filing an amended Federal tax return.

(e) * * *

(1) * * * If a taxpayer uses the optional method for rotatable parts for pools of rotatable and temporary spare parts for which the taxpayer does not use the optional method for its books and records, then the taxpayer must use the optional method for all its pools in the same trade or business, whether rotatable or temporary. * * *

* * * * *

(j) * * *

(3) * * * In applying §1.162-3T(d)(3), as contained in 26 CFR part 1, revised as of April 1, 2013, a taxpayer makes the election under §1.162-3T(d) by capitalizing the amounts paid to acquire or produce a material or supply in the taxable year the amounts are paid and by beginning to depreciate the costs when the asset is placed in service by the taxpayer for purposes of determining depreciation under the applicable provisions of the Internal Revenue Code and the Treasury Regulations. The election under §1.162-3T(d), as contained in 26 CFR part 1, revised as of April 1, 2013, does not apply to an asset or a portion thereof placed in service and disposed of in the same taxable year. * * *

Par. 3. Section 1.162-4 is amended by revising the last sentence of paragraph (a) to read as follows:

§1.162-4 Repairs.

(a) * * * Optionally, §1.263(a)-3(n) provides an election to capitalize amounts paid for repair and maintenance consistent with the taxpayer's books and records.

* * * * *

Par. 4. Section 1.263(a)-0 is amended by revising the entry in the outline of the regulations for §1.263(a)-2(f)(3)(ii) to read as follows:

§1.263(a)-0 Outline of regulations under section 263(a).

* * * * *

§1.263(a)-2 Amounts paid to acquire or produce tangible property.

* * * * *

(f) * * *

(3) * * *

(ii) Treatment of inherently facilitative amounts allocable to property not acquired.

* * * * *

Par. 5. Section 1.263(a)-1 is amended by:

1. Revising the second sentence of paragraph (f)(1).
2. Revising paragraphs (f)(1)(i)(B)(2), (f)(1)(ii)(B)(2), (f)(3)(iv), and (f)(3)(vii).
3. Revising the third sentence of paragraph (f)(5).
4. Revising the heading of paragraph (f)(7) Example 6.

The revisions read as follows:

§1.263(a)-1 Capital expenditures; in general.

* * * * *

(f) * * *

(1) * * * However, section 263A and the regulations under section 263A require taxpayers to capitalize the direct and allocable indirect costs of property produced by the taxpayer (for example, property improved by the taxpayer) and property acquired for resale.

(i) * * *

(B) * * *

(2) Amounts paid for property with an economic useful life (as defined in §1.162-3(c)(4)) of 12 months or less;

* * * * *

(ii) * * *

(B) * * *

(2) Amounts paid for property with an economic useful life (as defined in §1.162-3(c)(4)) of 12 months or less;

* * * * *

(3) * * *

(iv) Treatment of de minimis amounts. An amount paid for property to which a taxpayer properly applies the de minimis safe harbor contained in this paragraph (f) is not treated as a capital expenditure under §1.263(a)-2(d)(1) or §1.263(a)-3(d) or as a material and supply under §1.162-3, and may be deducted under §1.162-1 in the taxable year the amount is paid provided the amount otherwise constitutes an ordinary and necessary expense incurred in carrying on a trade or business.

* * * * *

(vii) Combined expensing accounting procedures. For purposes of paragraphs (f)(1)(i) and (f)(1)(ii) of this section, if the taxpayer has, at the beginning of the taxable year, accounting procedures treating as an expense for non-tax purposes amounts paid for property costing less than a specified dollar amount and amounts paid for property with an economic useful life (as defined in

§1.162-3(c)(4)) of 12 months or less, then a taxpayer electing to apply the de minimis safe harbor under this paragraph (f) must apply the provisions of this paragraph (f) to amounts qualifying under either accounting procedure.

* * * * *

(5) * * * Sections 301.9100-1 through 301.9100-3 of this chapter provide the rules governing extensions of the time to make regulatory elections.* * *

* * * * *

(7) * * *

Example 6. De minimis safe harbor; non-invoice additional costs. * * *

* * * * *

Par. 6. Section 1.263(a)-2 is amended by:

1. Revising the second sentence of paragraph (d)(1).
2. Revising the second sentence of paragraph (f)(2)(iv)(A) and the fifth sentence of paragraph (f)(2)(iv)(B).
3. Revising the heading of paragraph (f)(3)(ii).
4. Removing the text “section” in the last sentence of paragraph (h)(2).

The revisions read as follows:

§ 1.263(a)-2 Amounts paid to acquire or produce tangible property.

* * * * *

(d) * * *

(1) * * * Section 1.263(a)-3(f) provides the rules for determining whether amounts are for leasehold improvements.* * *

* * * * *

(f) * * *

(2) * * *

(iv) * * *

(A) * * * However, section 263A provides rules for employee compensation and overhead costs required to be capitalized to property produced by the taxpayer or to property acquired for resale.

(B) * * * Sections 301.9100-1 through 301.9100-3 of this chapter provide the rules governing extensions of the time to make regulatory elections. * * *

* * * * *

(3) * * *

(ii) Treatment of inherently facilitative amounts allocable to property not acquired. * * *

* * * * *

Par. 7. Section 1.263(a)-3 is amended by:

1. Revising the second and third sentences of paragraph (d) and adding a new fourth sentence.

2. Revising the second sentence of paragraph (e)(2)(i).

3. Revising first and third sentences of paragraph (f)(2)(i).

4. Revising the first, second, and last sentences of paragraph (f)(3)(i).

5. Removing the eighth sentence of paragraph (g)(2)(ii) Example 3.

6. Revising paragraph (h)(4).

7. Revising the last sentence of paragraph (h)(5)(ii).

8. Revising the second sentence of paragraph (h)(6).

9. Revising the first sentence and removing the second sentence of paragraph (i)(6) Example 3(ii).
10. Revising the next to the last sentence of paragraph (j)(3) Example 11 and removing the last sentence of this paragraph.
11. Revising paragraphs (k)(1)(v) and (k)(1)(vi).
12. Revising the first sentence of paragraph (k)(2).
13. Revising the last sentence of paragraph (k)(7) Example 7.
14. Removing the sixth sentence of paragraph (k)(7) Example 30.
15. Revising the second sentence of paragraph (n)(2).

The revisions and addition read as follows:

§1.263(a)-3 Amounts paid to improve tangible property.

* * * * *

(d) * * * However, paragraph (f) of this section applies to the treatment of amounts paid to improve leased property. Section 263A provides the requirement to capitalize the direct and allocable indirect costs of property produced by the taxpayer and property acquired for resale. Section 1016 provides for the addition of capitalized amounts to the basis of the property, and section 168 governs the treatment of additions or improvements for depreciation purposes. * * *

* * * * *

(e) * * *

(2) * * *

(i) * * * Paragraph (e)(2)(iii) of this section provides the unit of property for condominiums, paragraph (e)(2)(iv) of this section provides the unit of property for cooperatives, and paragraph (e)(2)(v) of this section provides the unit of property for leased buildings.

* * * * *

(f) * * *

(2) * * *

(i) * * * A taxpayer lessee must capitalize the related amounts, as determined under paragraph (g)(3) of this section, that it pays to improve, as defined under paragraph (d) of this section, a leased property except to the extent that section 110 applies to a construction allowance received by the lessee for the purpose of such improvement or when the improvement constitutes a substitute for rent. * * * A taxpayer lessee must also capitalize the related amounts that a lessor pays to improve, as defined under paragraph (d) of this section, a leased property if the lessee is the owner of the improvement, except to the extent that section 110 applies to a construction allowance received by the lessee for the purpose of such improvement. * * *

* * * * *

(3) * * *

(i) * * * A taxpayer lessor must capitalize the related amounts, as determined under paragraph (g)(3) of this section, that it pays directly, or indirectly through a construction allowance to the lessee, to improve, as defined in paragraph (d) of this section, a leased property when the lessor is the owner of

the improvement or to the extent that section 110 applies to the construction allowance. A lessor must also capitalize the related amounts that the lessee pays to improve a leased property, as defined in paragraph (e) of this section, when the lessee's improvement constitutes a substitute for rent. * * * See paragraph (e)(2) of this section for the unit of property for a building and paragraph (e)(3) of this section for the unit of property for real or personal property other than a building.

* * * * *

(h) * * *

(4) Eligible building property. For purposes of this section, the term eligible building property refers to each unit of property defined in paragraph (e)(2)(i) (building), paragraph (e)(2)(iii)(A) (condominium), paragraph (e)(2)(iv)(A) (cooperative), or paragraph (e)(2)(v)(A) (leased building or portion of building) of this section, as applicable, that has an unadjusted basis of \$1,000,000 or less.

(5) * * *

(ii) * * * Section 1.263(a)-4(f)(5)(ii) provides the factors that are significant in determining whether there exists a reasonable expectancy of renewal for purposes of this paragraph.

(6) * * * Sections 301.9100-1 through 301.9100-3 of this chapter provide the rules governing extensions of the time to make regulatory elections. * * *

* * * * *

(i) * * *

(6) * * *

Example 3. * * *

(ii) The additional aircraft engines are rotatable spare parts under §1.162-3(c)(2) because they were acquired separately from the aircraft, are removable from the aircraft, and are repaired and reinstalled on other aircraft or stored for later installation. * * *

* * * * *

(j) * * *

(3) * * *

Example 11. * * * Under paragraph (g)(4) of this section, City C's new requirement that K's building meet certain safety standards to continue to operate is not relevant in determining whether the amount paid improved the building.

* * * * *

(k) * * *

(1) * * *

(v) Results in the rebuilding of the unit of property to a like-new condition as determined under paragraph (k)(5) of this section after the end of its class life as defined in paragraph (i)(4) of this section; or

(vi) Is for the replacement of a part or combination of parts that comprise a major component or a substantial structural part of a unit of property as determined under paragraph (k)(6) of this section.

(2) * * * An amount is paid to improve a building if it is paid to restore, as defined under paragraph (k)(1) of this section, a property specified under

paragraph (e)(2)(ii) (building), paragraph (e)(2)(iii)(B) (condominium), paragraph (e)(2)(iv)(B) (cooperative), or paragraph (e)(2)(v)(B) (leased building or portion of building) of this section. * * *

* * * * *

(7) * * *

Example 7. * * * However, paragraphs (k)(1)(vi) and (k)(6) of this section are applicable for determining whether any amounts must be capitalized because they are paid for the replacement of a major component or a substantial structural part of the unit of property.

* * * * *

(n) * * *

(2) * * * Sections 301.9100-1 through 301.9100-3 of this chapter provide the rules governing extensions of the time to make regulatory elections. * * *

Par. 8. Section 1.263A-1 is amended by revising paragraph (l) to read as follows:

§ 1.263A-1 Uniform capitalization of costs.

* * * * *

(l) Effective/applicability date--(1) In general. Except as provided in (l)(2), (l)(3), and (l)(4) of this section, the effective dates for this section are provided in paragraph (a)(2) of this section.

(2) Mixed service costs; self-constructed tangible personal property produced on a routine and repetitive basis. Paragraphs (h)(2)(i)(D), (k), and (l)(2) of this section apply for taxable years ending on or after August 2, 2005.

(3) Costs allocable to property sold; indirect costs; licensing and franchise costs. Paragraphs (c)(5), (e)(3)(i), and (e)(3)(ii)(U) of this section apply for taxable years ending on or after January 13, 2014.

(4) Materials and supplies--(i) In general. The last sentence of paragraphs (e)(2)(i)(A) and (e)(3)(ii)(E) of this section, and paragraph (l)(4) of this section apply to amounts paid (to acquire or produce property) in taxable years beginning on or after January 1, 2014.

(ii) Early application of this section. A taxpayer may choose to apply the last sentence of paragraphs (e)(2)(i)(A) and (e)(3)(ii)(E) of this section, and paragraph (l)(4) of this section to amounts paid (to acquire or produce property) in taxable years beginning on or after January 1, 2012.

(iii) Optional application of TD 9564. A taxpayer may choose to apply §1.263A-1T(b)(14), the introductory phrase of §1.263A-1T(c)(4), the last sentence of §1.263A-1T(e)(2)(i)(A), the last sentence of §1.263A-1T(e)(3)(ii)(E), §1.263A-1T(l), and §1.263A-1T(m)(2), as these provisions are contained in TD 9564 (76 FR 81060) December 27, 2011, to amounts paid (to acquire or produce property) in taxable years beginning on or after January 1, 2012, and before January 1, 2014.

Martin V. Franks, Branch Chief
Publications and Regulations Branch
Legal Processing Division
Associate Chief Counsel
(Procedure and Administration).

[FR Doc. 2014-17080 Filed 07/18/2014 at 8:45
am; Publication Date: 07/21/2014]